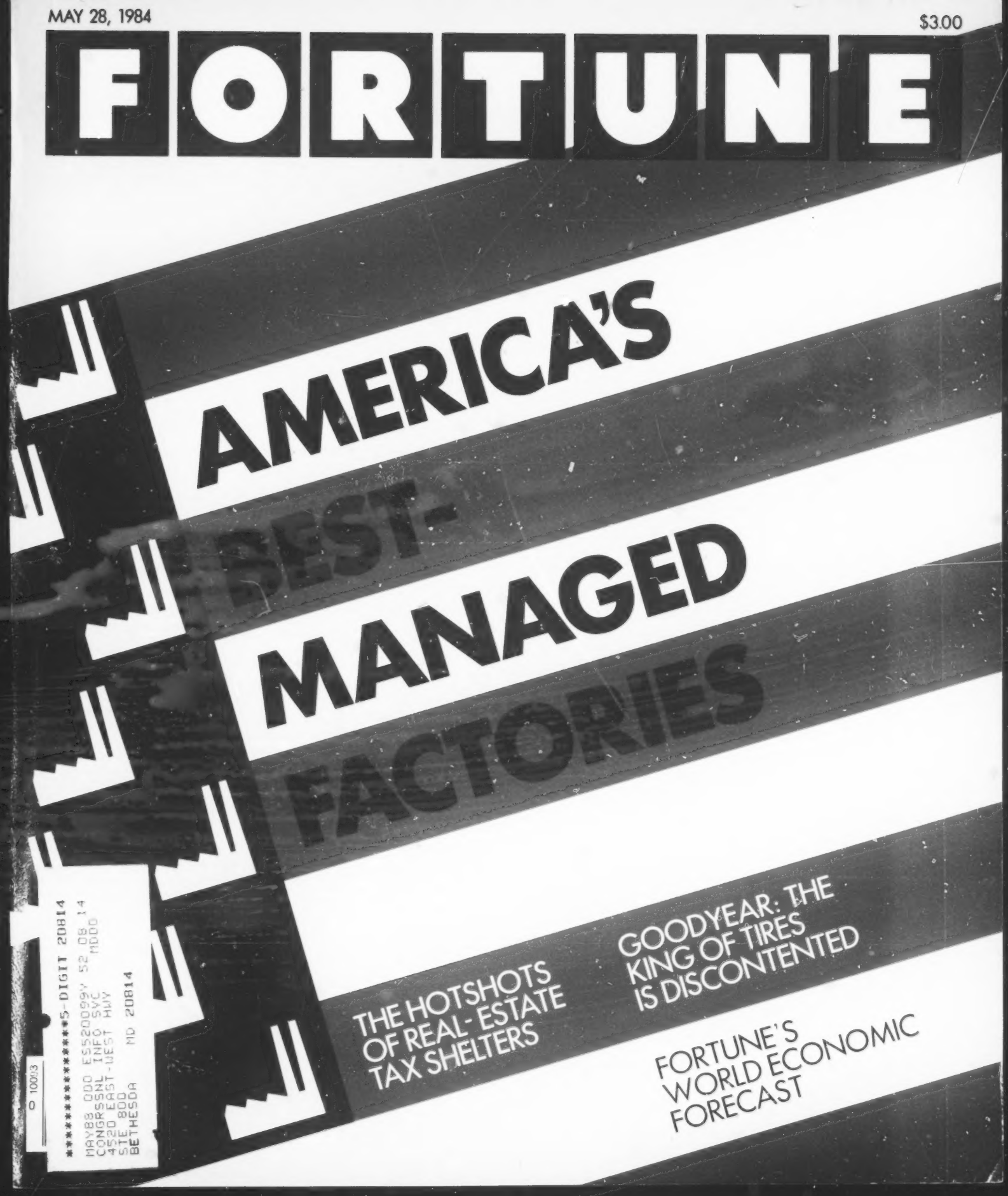
MAY 28, 1984

$3.00

FORTUNE



0 10093
*********5-DIGIT 20814
MAY88 ODO ES5200999Y 52 08 14
CONGRSSNL INFO SVC MDOO
4520 EAST-WEST HWY
STE 800
BETHESDA MD 20814

MAY 28, 1984 VOL. 109, NO. 11

FORTUNE

FORTUNE's associate art director, Leo McCarthy, designed the graphic representation of America's best factories for the cover. To find out which ones lead the rest and why, turn to page 16.

MANAGING

America's Best-Managed Factories 16
Ten that employ the most effective techniques today. *by Gene Bylinsky*

Fitting New Employees into the Company Culture 28
Here's how the most successful companies do it. *by Richard Pascale*

THE ECONOMY

Fortune Forecast: The World Recovery on a High-Risk Course 46

CORPORATE PERFORMANCE

Conglomerates Are Doing Better than You Think 50
Their bad reputation doesn't square with today's facts. *by Royal Little*

Goodyear: The King of Tires Is Discontented 64
It hungers for faster growth—outside the rubber business. *by Kenneth Labich*

VisiCorp: A Software Champ Takes It on the Chin 70

SELLING

Smoking U.S. Cigarettes Is Dangerous in Korea 89

Pasta: On the Road to a National Noodle 93

Ricoh's Foray into Xerox's Heartland 94

TECHNOLOGY

The Race to Perfect the Flat Screen 97
Demand is booming thanks to the success of portable computers, but the technology is elusive. *by Gary Hector*

MONEY & MARKETS

An Upstart Roils a Tax Shelter Game 133
Rivals say an aggressive real estate syndicator has stirred up Congress and spoiled the fun. *by Ford S. Worthy*

Japan Hustles for Foreign Investment 152
The Japanese have decided that new plants built with foreign money are just what they need. *by Lee Smith*

Larry Tisch Is Flush with Cash 165
The Loews chairman is sitting on a bankroll waiting for a bull market in bonds. *by Gwen Kinkead*

Eastern Europe Pays Off Some Bank Loans 168

POLITICS & POLICY

Maybe Acid Rain Isn't the Villain 170
Recent scientific findings suggest that acidified lakes may have got that way naturally. *by William M. Brown*

How to Get a Piece of the Political Conventions 179

Stiffing Steel 179

The U.S. Tax Code Has an Antilles Heel 180

PROFILE

Shell Oil's Man in the Middle 182
Royal Dutch/Shell's bid put John Bookout on the spot. *by Peter Nulty*

People to Watch 185

The Editor's Desk 4

News/Trends 6
China's so-called capitalism, IBM's second front, McDonald's tries out major leagues, banks get off their assets, electronic off-track betting, and more.

Follow-Up 9
The Mac that roared, educating America, TI rebounds, Mary Cunningham's revenge.

Letters to Fortune 13

Keeping Up 189
by Daniel Seligman

Personal Investing 195
Little life insurance companies. Sallie Mae stock. Call options. Portfolio Talk: investment adviser Richard Hoffman.
by John J. Curran

On the Road 205
The Boston exurbs.
by Patricia A. Langan

Books & Ideas 215
The case for the AFL-CIO.
by Daniel Seligman

Office Hours 219
Executive guilt.
by Walter Kiechel III

CONGLOMERATES ARE DOING BETTER THAN YOU THINK

The 88-year-old founder of Textron finds—contrary to myth—that diversified companies outperform nondiversified companies, especially in hard times. Unfortunately, he adds, diversifying by acquisition is a lot more expensive today than it used to be. ■ *by Royal Little*

AS THE FOUNDER of the first conglomerate, Textron, I am particularly interested in dispelling the myths that surround these companies. They are reputed to be less profitable than nondiversified companies and to trade at a discount on the stock market. The surprising truth is that, measured by return on shareholders' equity, the conglomerates are outperforming the rest of industry and their shares recently sold at higher price-earnings multiples.

To get at the facts about conglomerates, I have—with the help of FORTUNE's staff—compared the performance of 39 conglomerates and 226 nondiversified industrial companies on the FORTUNE 500 list that had more than $1 billion in sales in 1983. We took the comparison back to 1978, the year the Securities and Exchange Commission required companies to begin reporting on the performance of their divisions. Before then it was hard to tell how many lines of business a company was in. How many businesses must a company be in to qualify as a conglomerate? There's no universal definition. For this article, I used FORTUNE's rule: a conglomerate must have at least four unrelated businesses, none accounting for more than 50% of its sales. (For more information on the methods used, see the table on page 52.)

The nondiversified companies did produce a higher median return on shareholders' equity in 1978 and 1979. But in 1980 the performance of the two types of companies tied, and during the next three years conglomerates came out ahead. Moreover, the conglomerates achieved a greater margin of superiority than the nondiversified companies did in their good years.

RESEARCH ASSOCIATE *Lorraine Carson*

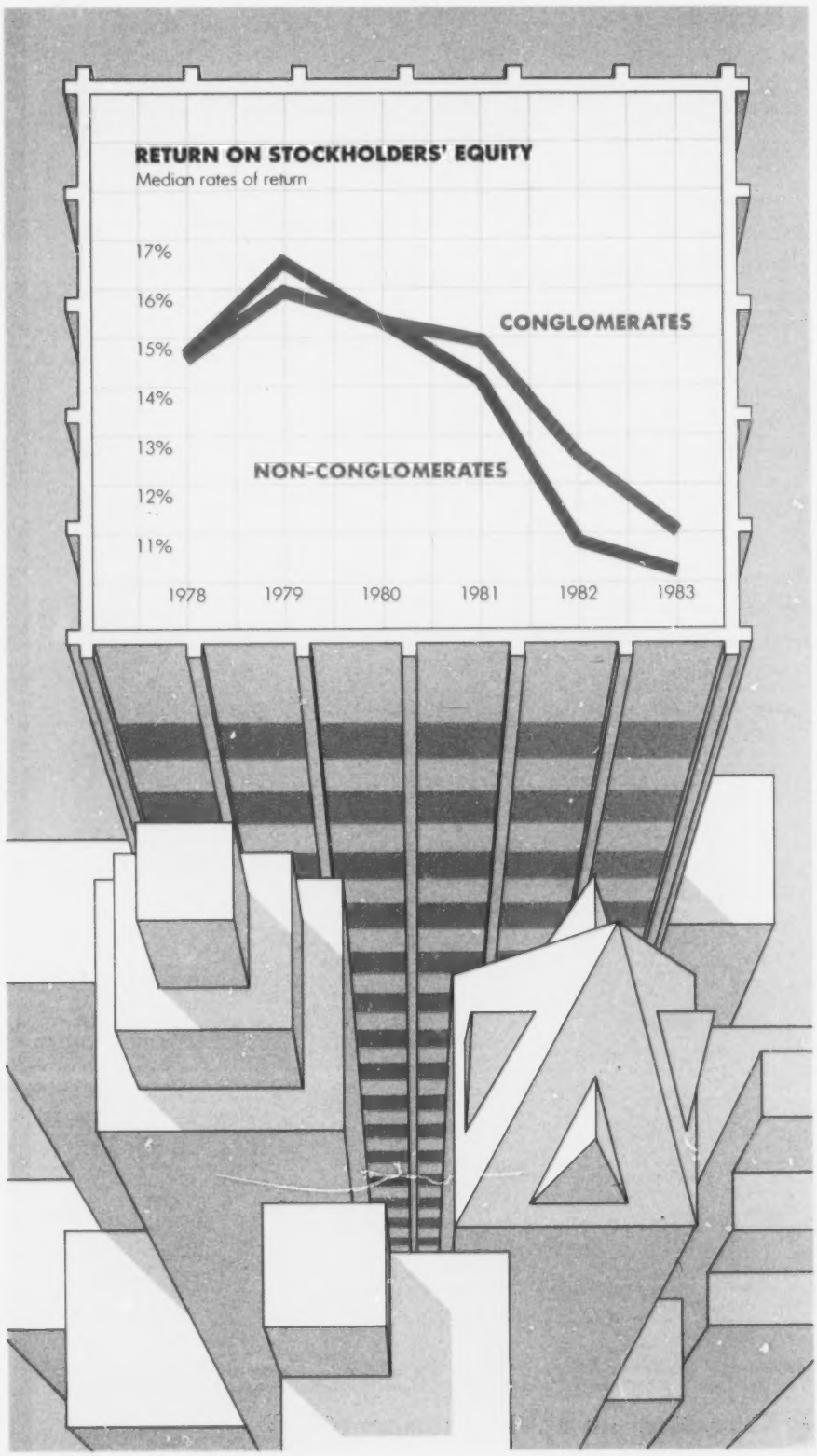
The recession year of 1982 shows emphatically how diversity protects a company from business cycles. The conglomerates scored a median return of 12.5% vs. 10.8% for the others. Only three conglomerates on our list lost money that year. And two, Colt Industries and Crane Co., hit the skids because they had got too involved in a single business—steel. Many nondiversified companies had terrible losses in 1982. Bethlehem Steel and International Harvester lost more than $1 billion each. Nine other companies among the FORTUNE 500 dropped between $50 million and $100 million, and 18 dropped between $100 million and $1 billion. Total deficits among nondiversified industrials amounted to $8.2 billion. Service companies were badly hurt too. Federally insured savings and loan institutions lost $4.3 billion and the airlines $916 million.

Judging by median price-earnings multiples, the so-called conglomerate discount no longer exists—and I'm not sure it ever was significant. Wall Street may have just found the companies hard to analyze. At the end of 1978, 1979, and 1982 the nondiversified companies sold at a slightly higher multiple than the conglomerates. The two kinds of companies were tied for 1981, and the conglomerates had a higher multiple for 1980 and 1983. Conglomerates are better understood now—though Wall Street still hasn't put enough well-trained specialists on the job of following them. They sold for a median price-earnings multiple of 12 in 1983, compared with 11 for the nondiversified companies, which reflects the growing appreciation of the advantage they have in bad years.

The advantage is becoming more significant because the return on net worth of the FORTUNE 500 has been falling for the past four years. Even in 1983, a good year, 70 of the 500 industrials lost money. With severe foreign competition, heavy industry faces a difficult future in this country. But if you are diversified it won't kill you if you have a business that's not doing too well, and you can even get right out of an industry that looks bad. Of the 60 FORTUNE 500 money losers last year, only four were conglomerates. As things get tougher the conglomerates will look better.

Safety in recession years is only one reason for diversifying. Others include getting out of a low-growth or low-return industry, or expanding without violating the antitrust laws. Most manufacturing companies are diversified to some extent, even if they can't be classified as conglomerates. Only a few top high-technology companies—IBM, Wang, Hewlett-Packard—have not diversified. They have all the growth they need and their return on capital is excellent.

The key to running a conglomerate well is to give the division managers the authority to run their own shows—but to make sure they are motivated. You must have people who are competent in their businesses, and you don't want to restrict them too much, except for approval from the board of directors for things like capital expenditures. In Textron we gave the division managers tremendous latitude, but we put some pressure on



Strength in Diversity

Measured by their return on stockholders' equity, the largest conglomerates on the FORTUNE 500 have been outperforming the largest nondiversified companies. The conglomerates trailed in 1978 and 1979, but have held up much better in recent years.

them every month by ranking them in order of performance. So a division manager was No. 1, No. 2, or No. 10. That was a clear incentive. We also gave them a carrot. The managers could earn cash bonuses of up to 100% of their salaries, depending on the return on capital they achieved.

My reason for diversifying was to break out of a low-return industry. I had been carrying around the idea of creating a diversified company for a long, long time. In 1923 I had set up my own company in South Boston, Special Yarns Corp., which eventually became Textron. A couple of years later Eliot Farley, who was my former boss and had helped me set up the company, said to me, "Royal, some day you ought to consider getting diversified and I've even got the name. You should call it Disassociated Industries." I thought he was crazy. Thirty years later, when I was 57, I finally got smart.

TEXTRON REMAINED very small until World War II. During the 1930s we just battled to keep from going broke all the time. After the war we found ourselves in a highly cyclical business with a low return on capital. Most Southern textile mills were controlled by families and were producing greige goods—unfinished, undyed fabric—in a highly competitive market. When profits were high, the last thing the owners wanted was to pay out a lot of dividends on which they would pay 70% taxes, which was the top bracket then. But any accumulation of surplus earnings deemed by the government "unreasonable" made the companies subject to a 38.5% penalty tax. So what did the mass producers do? They poured money into new mills that weren't needed and turned out cotton fabrics the market couldn't absorb except at much lower prices. That's how the tax laws helped make the textile industry unattractive to the investor. And it's typical of single-industry companies to overexpand in boom times.

Suspicion about conglomerates is nothing new—I ran into it when I started diversifying. We held a special stockholders' meeting on June 30, 1952, to change the articles of association so we could buy businesses outside textiles. The stockholders approved and the board was enthusiastic. Unfortunately no one else was. The entire financial community thought I was crazy.

I found that out when we tried to finance our first deal in 1953. We wanted to buy the Burkart Manufacturing Co. It had started out making horse blankets in St. Louis and graduated to auto seat stuffing. I needed several million dollars to buy the company. When I approached Roger Damon, president of the First National Bank of Boston, he said,

ILLUSTRATIONS BY KARL HARTIG

"Roy, your idea of unrelated diversification just won't work. No one person can possibly run 30 different businesses. However, we are going to support you on this one acquisition, hoping you will abandon the whole concept in the future." We raised the working capital by borrowing on all of Textron's receivables, and our profit-sharing plan bought the fixed assets and leased them to us.

We acquired two other companies early in 1954, Dalmo Victor and MB Manufacturing, and then we ran out of money. At that point we could have remained a struggling textile company with three small nontextile divisions. But we were able to secure loans to buy a position in American Woolen Co., and after a year-long court battle—during which we proved that American Woolen's management had used 75,000 forged proxies—we won control. That gave us $75 million in working capital and a $30-million tax loss carry-forward. By the time I retired in 1961 we had bought around 100 companies, mostly small and often family-owned.

YOU HAD TO FIND companies that had the potential, even if they were very small, to increase earnings either by growing or by reducing costs. When we bought a chainsaw company called Homelite Corp. in 1955, it was tiny compared with its competitor, McCulloch Corp. But we knew McCulloch had a high-cost operation beside the Los Angeles airport. So we moved Homelite out of unionized New England and built beautiful new plants down South, and we beat McCulloch with lower costs. Since I am interested in golf, we bought the E-Z-Go Golf Cart Co. in 1960 when it was doing about $1 million in sales. We expanded its low-cost operation in Augusta, Georgia, and we put Cushman Co. right out of the golf-cart business. Homelite and E-Z-Go's sales, along with those of two small metal fastener companies we acquired in the 1950s, Townsend Co. and Camcar Manufacturing Co., are now more than ten times what they were when we bought them.

To get into defense contracting, we acquired three divisions of the Bell Aircraft Corp. in 1960, when their sales were only $100 million a year. Now their sales are way over $1 billion a year. Of course, we had a lot of disasters too, but none big enough to hurt us seriously. I wrote a book about them, *How to Lose $100 Million and Other Valuable Advice*, adapted for FORTUNE in the August 27, 1979, issue. It was the first book by a businessman pointing out all his mistakes.

My goal at Textron was to increase the re-

CONGLOMERATE 1983 SALES in millions	RETURN ON STOCKHOLDERS' EQUITY, 1978-83 MEDIAN	HIGH	LOW
Teledyne $2,979	**24.4%**	**29.2%** 1979	**11.5%** 1983
Minnesota Mining & Manufacturing $7,039	**20.1%**	**22.2%** 1979	**17.8%** 1982
Chesebrough-Pond's $1,685	**19.8%**	**20.0%** 1982	**17.8%** 1978
Litton Industries $4,719	**19.6%**	**24.9%** 1980	**Loss** 1978
American Standard $2,182	**19.3%**	**24.7%** 1980	**5.8%** 1982
Emerson Electric $3,475	**19.3%**	**19.7%** 1981	**17.8%** 1983
Northwest Industries $1,976	**19.2%**	**41.1%** 1981	**Loss** 1983
Lear Siegler $1,464	**18.6%**	**20.9%** 1979	**13.3%** 1983
Marmon Group $1,467	**18.6%**	**25.1%** 1979	**10.6%** 1983
General Electric $26,797	**18.3%**	**19.1%** 1979	**17.8%** 1982
Gillette $2,183	**17.3%**	**19.3%** 1983	**16.1%** 1978
Emhart $1,686	**16.5%**	**18.2%** 1978	**12.9%** 1979
TRW $5,493	**16.3%**	**16.9%** '78-'79	**12.7%** 1983
Parker Hannifin $1,038	**16.0%**	**17.5%** 1979	**6.5%** 1983
Perkin-Elmer $1,015	**16.0%**	**17.9%** 1980	**9.8%** 1983
Rockwell International $8,098	**16.0%**	**17.0%** 1979	**13.0%** 1978
Dresser Industries $3,473	**15.9%**	**16.6%** 1978	**0.3%** 1983
Tenneco $14,353	**15.6%**	**17.4%** 1980	**12.3%** 1983
Colt Industries $1,576	**15.2%**	**21.3%** 1983	**Loss** 1982
Ogden $1,918	**14.6%**	**15.5%** 1978	**10.8%** 1982
W.R. Grace $6,220	**14.4%**	**17.5%** 1981	**7.3%** 1983
United Technologies $14,669	**13.9%**	**15.3%** 1982	**13.0%** 1979
Honeywell $5,753	**13.6%**	**15.9%** 1979	**10.0%** 1983
Gulf & Western $5,072	**13.2%**	**15.3%** 1980	**Loss** 1983
Borg-Warner $3,542	**13.1%**	**14.4%** 1979	**10.9%** 1980
Brunswick $1,216	**13.0%**	**52.8%** 1982	**5.3%** 1980
Kidde $2,330	**13.0%**	**14.6%** 1979	**Loss** 1983
Signal Companies $6,151	**12.9%**	**17.2%** 1979	**3.9%** 1983
North American Philips $3,800	**12.6%**	**14.3%** 1979	**9.4%** 1982
FMC $3,498	**11.6%**	**13.4%** 1978	**10.8%** 1981
ITT $14,155	**11.3%**	**14.3%** 1980	**6.8%** 1979
SCM $1,813	**10.8%**	**11.8%** 1980	**4.8%** 1983
National Distillers & Chemical $2,267	**10.7%**	**14.9%** 1979	**6.8%** 1983
Crane $1,003	**10.6%**	**14.8%** 1979	**Loss** '82-'83
Textron $2,980	**10.0%**	**16.5%** 1978	**6.9%** 1982
American Can $3,346	**9.5%**	**12.0%** 1979	**Loss** 1982
IC Industries $3,864	**8.8%**	**14.4%** 1979	**4.2%** 1982
U.S. Industries $1,076	**8.2%**	**9.7%** 1979	**Loss** 1981
Williams Companies $2,167	**7.0%**	**14.4%** 1980	**1.8%** 1978

A Compendium of Conglomerates

Who's hot and who's not among conglomerates is illustrated by the 39 listed above, chosen from the 295 FORTUNE 500 industrial companies with $1 billion or more in 1983 sales. FORTUNE defines conglomerates as companies engaged in at least four different businesses, none accounting for more than 50% of sales—which eliminates some, like Raytheon, often considered conglomerates. Also excluded are co-ops and companies that weren't on the 500 list all six years.

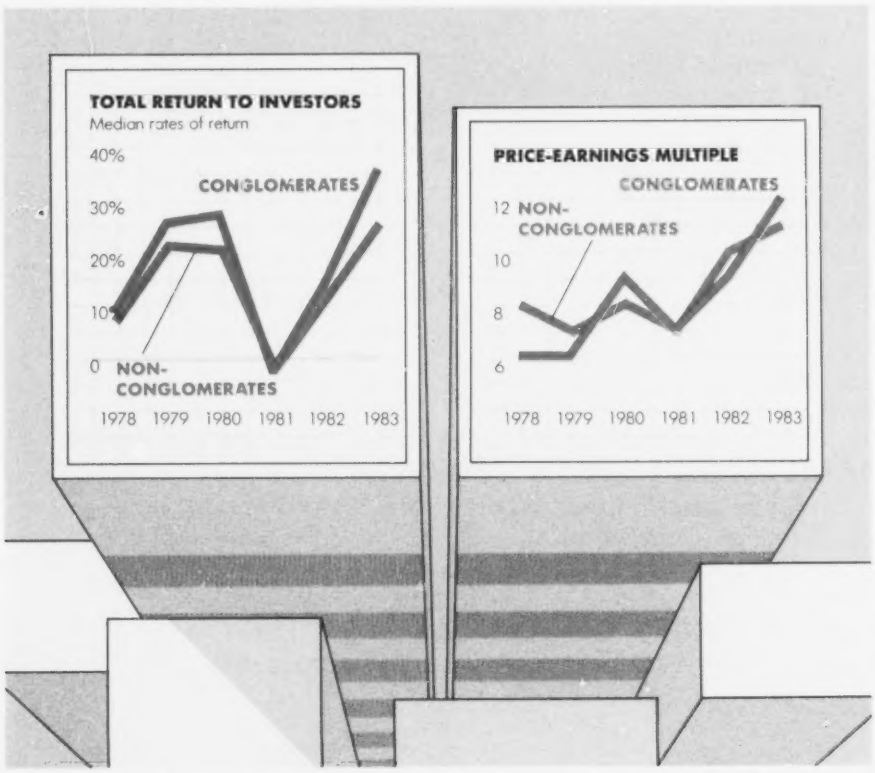
turn on average common stockholders' equity from 5% or 6% annually, the usual rate when it was just a textile company, to 20%. The company met that goal in 1967. Unfortunately the return at Textron has slipped back down to 7.1%. It has bought no large manufacturing business in the last ten years. Sales grew only from $1.9 billion to $3 billion in the last ten years, while other conglomerates that used to be smaller than Textron have left it behind. United Technologies, which was about the same size as Textron ten years ago, is up to nearly $15 billion in sales.

While Textron diversified to escape the low returns, other companies did so to break out of businesses with limited growth potential. The Emerson Electric Co. is an outstanding example. When Wallace "Buck" Persons took over in 1956, Emerson was a little company making small electric motors. Persons made unusually astute acquisitions and monitored the divisions closely. He would have the top managers in to a meeting once a month and go over things in detail to put pressure on them. But his greatest feat was to establish good relations with the financial community. Unlike other executives, he spent a lot of time talking to people in the investment business and he got their confidence. As a result, Emerson's price-earnings multiple was around 30 for many years.

The unusually high ratio permitted Persons to buy some fine companies using stock instead of cash, while most of Textron's acquisitions had to be made with cash because we had a lower multiple. He could afford to pay 15 times earnings for a company. Charles F. Knight took over from Persons in 1974 and has maintained a record I don't think any other conglomerate can match: Emerson has raised its total earnings and earnings per share every year since Persons took over 26 years ago.

Minnesota Mining & Manufacturing started out mining fluorspar and using it to make sandpaper. You couldn't get much less scope than that. I'm told there was a time in the taverns of northern Minnesota when you could buy two shares of 3M for a shot of whiskey. William McKnight, who led the company from 1929 to 1966, believed in research and development, and much of 3M's diversification was achieved by creating new products instead of acquiring other companies. The company has never paid a big dividend, but the dividends have increased for 26 consecutive years and have always kept ahead of inflation. For a decade sales have grown faster than the FORTUNE 500's sales. Even in 1982 3M's sales gained.

At Textron we took advantage of tax loss carry-forwards, but for some companies these were the main reason for conglomerating. The railroads built up tax losses they couldn't use unless they diversified. Ben Heineman, who became chief executive of the Chicago & North Western Railroad in 1956, diversified successfully during the 1970s after changing the name to Northwest Industries, and used up the railroad's huge carry-forwards. He got rid of the railroad by selling it to the employees. The Illinois Central diversified as IC Industries but hung on to the railroad, so its median return on net worth in the last six years was only 8.8%, compared with 19.2% for Northwest Industries. But if IC had remained just a railroad, it would still probably be making nothing but tax loss carry-forwards.



Winning the Market's Favor

Measured by total return to investors—dividends plus stock price appreciation—conglomerates did better than nondiversified companies except in 1981, when investors in both types took baths (chart at left). As the market awakened to the conglomerates' performance in 1979, the conglomerate discount disappeared (right). The price-earnings multiples were measured at year's end.

SOME COMPANIES diversify to get into lucrative defense businesses—Textron, fortuitously, bought the Bell units just before the Army decided to equip all its divisions with helicopters—but other companies worry when too much of their profit comes from defense contracts, which can be unreliable. United Technologies got to be too dependent on Pentagon contracts. Harry Gray has done a terrific job of diversifying the company, especially with the purchase of Otis Elevator and Carrier Corp. in the late 1970s. He was the first businessman to make unfriendly tender offers relatively respectable among lenders. Many banks wouldn't touch an unfriendly offer before he started making them in 1976, but Gray was a pretty important customer.

The idea of diversifying is so appealing that some companies were created just to be conglomerates. Teledyne is one of those, and from the point of view of the stockholder, it is probably the best of the diversified companies. Like many successful conglomerates, Teledyne is the creation of one strong man. Henry Singleton left Litton Industries in 1960 to start it, and he remains the chief executive to this day. He made many unrelated acquisitions, just as I did, but he made fewer mistakes. *continued*

Some of Singleton's policies were considered pretty unorthodox in the investment community. Teledyne has never paid a cash dividend, for example. Singleton purchased large positions in several major corporations. A $49.1-million write-down of its International Harvester shares hurt Teledyne's stock in 1982, but other investments paid off, especially Singleton's purchase of a 25% interest in Litton Industries at an average price of $12.50 between 1975 and 1978. Litton shares traded for $68 late in April.

No other company I know of has ever bought in such a large percentage of its own shares and stayed public. The company has reduced its outstanding shares to 20.4 million from a peak of 89 million in 1971 (adjusted for subsequent splits and stock dividends). Anyone who has held Teledyne stock since the initial $1.9-million offering in 1960 has seen the investment increase by over 14,000%. That's better than 24% compounded annually.

Conglomerates were so successful in the 1960s that inevitably the whole thing got out of hand. Their managers found they could increase earnings per share just by making acquisitions, so long as their companies had higher multiples than the companies they acquired. An acquiring company would be buying earnings cheap and adding them to its own, and the market would almost invariably bid up its shares to reflect those added earnings. While Emerson Electric used this ploy wisely, other conglomerates started buying anything that came along. The break came in 1968, when investors began to understand how poor the quality of those earnings was.

Litton has symbolized the rise, fall, and revival of the conglomerate. When I bought Dalmo Victor in San Carlos, California, in 1954, I was told I should also buy a little company across the street called Electro-Dynamics Corp., which subsequently became Litton Industries. It was very limited in scope but highly profitable. Roy Ash and Tex Thornton took the company over and diversified into at least 20 different businesses. Litton's multiple got as high as 47. In the early 1960s it made the mistake of taking on two big companies that really had problems, Ingalls Shipbuilding in Pascagoula, Mississippi, and Royal McBee, the typewriter company. The problems finally caught up with the company in 1968, and Litton announced a decline in quarterly earnings for the first time in its 14 years. The shares went into a long decline, from $120.375 in 1968 to $2.875 in 1974. It took a long time to straighten out those companies but today Litton is once again a top performer in median return on stockholders' equity, ranking fourth among conglomerates over the past six years.

JIMMY LING built LTV up from nothing, but he got into real trouble when he sold the public 20% of his subsidiaries and then borrowed heavily on the remaining 80% of the overpriced shares. He bought the Jones & Laughlin Steel Co. with that money. But in 1969 LTV's earnings declined, and the price of the subsidiaries' stock came tumbling down. He was caught with too much debt, and that was the end of Jimmy Ling at LTV.

The spinoff trend started in 1972. The conglomerates had bought too many small companies, and they began selling the ones with the least growth potential to put more capital into the most promising divisions. That trend has slowed down now. By 1972, of course, I was out of Textron, but I was running Narragansett Capital Corp., a Small Business Investment Company, and we were able to pick up dozens of divested cash cows that weren't growing. We used leveraged buyouts, which enabled us to give the managers a piece of the action. So in a way I had the best of both conglomerate cycles—when they were diversifying in the 1950s and 1960s and when they were selling off in the 1970s.

Diversifying is as desirable today as ever, but a lot harder. When I was building up Textron 30 years ago, you could buy a company at eight times its annual earnings. Today you may have to pay 15 times earnings. I couldn't create a Textron today and make a decent return, nor could anybody else.

But for those who have already created a conglomerate, or anyone who can figure out how to do it without acquisitions today—say, by creating new products through research and development—my basic concept of unrelated diversification is as sound as ever. The bad reputation the conglomerates acquired in the late 1960s and early 1970s just doesn't square with the facts today. I would like to see FORTUNE start comparing the performance of conglomerates and nondiversified companies every year. A well-run diversified company shouldn't ever lose money. I may be sticking my neck out, but I think very few of the 39 examined for this article will lose money in the future. F

ROYAL LITTLE JUST KEEPS ON CLIMBING

■ Royal Little played his first game of golf in 1911. This year, at the age of 88, he expects to play in at least eight senior tournaments, and with a little luck he'll score better than his age in one of them. He has shot his age 25 times since he turned 83. As long as he can get a caddy, he never rides around the course in those carts made by Textron. "Gotta keep in shape," he says. His trim figure is a little bent now, but in shape he is. When he is at his office in Providence, Rhode Island, he walks up a steep hill every day to the Hope Club for his customary fruit salad lunch.

After he retired from Textron, Little—who was elected to FORTUNE's U.S. Business Hall of Fame in 1975—ran Narragansett Capital Corp., a Small Business Investment Company, and Amtel Inc., a conglomerate. These days he works as a merger and acquisitions consultant with his old friend Jim Robison, the former chief of Indian Head Corp., at a company called Lonsdale Enterprises. He is as eager as ever to jump in a jet and try to make a leveraged buyout that will earn a $1-million commission.

Staying in shape *at 88*